

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Federal-State Joint Board on)	CC Docket No. 96-45
Universal Service)	
)	
1998 Biennial Regulatory Review –)	
Streamlined Contributor Reporting)	CC Docket No. 98-171
Requirements Associated with Administration)	
of Telecommunications Relay Service, North)	
American Numbering Plan, Local Number)	
Portability, and Universal Service Support)	
Mechanisms)	
)	
Telecommunications Services for Individuals)	CC Docket No. 90-571
with Hearing and Speech Disabilities, and the)	
Americans with Disabilities Act of 1990)	
)	
Administration of the North American)	CC Docket No. 92-237
Numbering Plan and North American)	NSD File No. L-00-72
Numbering Plan Cost Recovery Contribution)	
Factor and Fund Size)	
)	
Number Resource Optimization)	CC Docket No. 99-200
)	
Telephone Number Portability)	CC Docket No. 95-116
)	
Truth-in-Billing and Billing Format)	CC Docket No. 98-170

REPLY COMMENTS OF NEXTEL COMMUNICATIONS, INC.

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SUMMARY

Only a few carriers back the Commission's immediate adoption of one or more of the connection-based universal service fund assessment proposals, as presented in the Second Further Notice of Proposed Rulemaking, for remedying the current maladies of the federal USF. These proposals do not conform with the equitable and competitive neutrality requirements of Section 254 and established Commission policies; but rather shift arbitrarily, in one way or another, the funding burden from one class of carriers to another and excuse entire carrier segments and service providers from any type of USF funding duty.

Those that support these connection-based funding proposals "as is" claim that the USF program, if left untouched, is unsustainable. Many of the underlying reasons these carriers cite for the USF unsustainability, however, can be easily addressed by the Commission requiring that all providers of telecommunications, including broadband service providers and providers of voice over Internet Protocol Services, contribute to the USF pool. USF funding should come from the broadest possible base of providers and services. To do otherwise will further exacerbate the existing mismatch between USF funding sources and what USF funds are subsidizing. Under the terms of the Rural Task Force Order, many rural ILECs appear to be rebuilding their networks using USF funds. Much of the funding for this comes from capital-constrained carriers, such as commercial mobile radio service providers, operating in fiercely competitive markets.

In addition to broadening the base of USF contributors, the Commission must make a critical addition to the underlying assumptions adopted by the *Staff Study* for each of the alternatives under consideration. Each must be modified to include the appropriate elasticity of

demand factor for each distinct service market – CMRS, IXC and LEC. Up to this point, critical decisions regarding USF contributions have been made based on ad hoc reasoning in the absence of sound guidance from established economic principles. The Commission now, however, has the opportunity to build on its existing work and to make any USF assessment method more consistent with the equitable (competitive neutrality) and nondiscriminatory requirements of Section 254 of the Communications Act, as amended.

The importance of including “elasticity of demand” as a factor in *any* contribution methodology, whether revenue-based or connection-based, cannot be understated. Failure to consider elasticity of demand in distinct markets for telecommunications services would be a failure of both law and sound economic policy, as well as a missed opportunity to enhance consumer and producer welfare. Applying known factors for the relative elasticity of demand for each service is not difficult and the results are significant. Those carriers experiencing the lowest elasticity of demand for their services, *i.e.*, the incumbent local exchange carriers, would contribute more to the USF in comparison to those carriers that experience a far higher elasticity of demand for their services, namely CMRS providers and interexchange carriers. Indeed, when an “elasticity of demand” component is added as one of the underlying assumptions in each of the assessment methods under consideration, an entirely different “contribution” results in each industry segment.

This is a logical result. Not all telecommunications carriers are created the same and face the same consumer demand for their services. Some carriers operate in fiercely competitive markets, while others do not. The burdens of funding USF and other mandatory programs do not fall evenly on every industry segment; this must be recognized and reflected in the Commission’s USF funding program to pass statutory muster. Fundamentally, therefore, USF

assessments should reflect the differences in demand for different services, and USF assessments should be adjusted for those services whose customers are far more sensitive to increases in price. This result not only benefits competitive markets, it also enhances consumer welfare. The Commission must add this basic and well-established economic framework to its USF assessment policies to conform with the requirements of Section 254.

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REPLY COMMENTS OF NEXTEL COMMUNICATIONS, INC.

Nextel Communications, Inc. (“Nextel”), by its attorneys, hereby submits these reply comments in response to the Federal Communications Commission’s (“Commission”) Second Further Notice of Proposed Rulemaking regarding proposed long-term modifications to the

*Reply Comments of Nextel Communications, Inc.
April 18, 2003
CC Docket No. 96-45*

revenue-based universal service fund (“USF”) contribution methodology and on the *Staff Study* regarding the alternative contribution methodologies.¹

I. INTRODUCTION

Nextel is one of six facilities-based “nationwide” Commercial Mobile Radio Service (“CMRS”) providers operating in the United States. Nextel currently serves over ten million customers throughout its service territories and has been a mandatory contributor to the federal USF program since 1997. Critically, Nextel’s contributions to the federal USF have more than quadrupled over the last five years as the applicable contribution factors have risen and as Nextel’s revenues and subscriber base have grown. Like the majority of commenters in this proceeding, Nextel is concerned over the rapid growth of the universal service fund and the increase in carrier assessments over the past several years.

What is abundantly evident from the comments filed is that the connection-based proposals set forth in the Second FNPRM do not conform with the requirements of Section 254 and, in one way or another, arbitrarily shift the funding burden from one class of carriers to another and exempt whole classes of carriers and service providers from funding responsibility. To alleviate the growing concerns over fund proliferation and ensure that all carriers contribute on an equitable and non-discriminatory basis, the Commission must require that all providers of telecommunications, including broadband service providers, contribute to the fund. In addition the Commission, in choosing the appropriate funding mechanism, ***must*** include in weighing USF

¹ Federal-State Joint Board on Universal Service et al., *Report and Order and Second Further Notice of Proposed Rulemaking*, CC Docket No. 96-45, FCC 02-329 (rel. December 13, 2002) (“Report and Order” and “Second FNPRM” or “FNPRM”); Wireline Competition Bureau Staff Study of Alternative Contribution Methodologies (hereinafter “*Staff Study*”).

assessments the conditions of demand that each telecommunications segment faces in today's marketplace. Such considerations of "elasticity of demand" for service are critical to the continued development of competition in local markets and the overall sustainability of the USF.

II. THERE IS LIMITED SUPPORT FOR ADDITIONAL, RADICAL CHANGE IN USF ASSESSMENT METHODS

A. A Full-Scale Departure from the Current Revenue-Based USF Program Is Not Justified

The current revenue-based USF collection mechanism must not be changed to a connection-based system absent ample proof – which has not been presented – that such a change will ensure the long-term viability of the fund.² Despite continued attempts by the Commission, at the behest of the interexchange industry, to refine the leading forms of a "connection-based" assessment method, the comments demonstrate little appetite for more and more radical changes, particularly those that adversely affect services that are more sensitive to price increases. The Commission's *Staff Study* demonstrates, depending upon the assumptions made, that modifications to the USF contribution methodology could make the effective rate of the USF assessment grow less rapidly over the next five years. In and of itself, however, this result will not alleviate concerns over the uncontrolled growth of the fund and the effect USF and other taxes, fees and assessments have on consumers' willingness to purchase telecommunications products and services. Additionally, the proposed connection-based

² See Report and Order at ¶ 1 (noting that the interim measures adopted were designed to "maintain the viability of universal service in the near term – *a fundamental goal of this Commission.*") (emphasis added).

methodologies fail, in their present state, to comply with the Act's requirement that all carriers contribute to the fund on an equitable and nondiscriminatory basis.³

It is only the IXC's, with their assertions of discriminatory treatment, that support one or more forms of the proposed radical USF funding methodology changes. AT&T Corporation, WorldCom, Inc., and Sprint Corporation argue that *any* revenue-based assessment mechanism is flawed; however, they offer nothing but the same allegations of a USF "death spiral" and unfair or inequitable treatment under the current system to back up these assertions.⁴ The Commission must view these claims with a high degree of skepticism and should not be swayed by unsupported claims of unsustainability. Notwithstanding these protestations, the real issue is whether the Commission and the public will tolerate double digit USF assessments on carriers (and ultimately customers) to pay for the program and the unfair shifting of the majority of the funding burden to competitive services.

As Nextel explained in its comments, the Commission's failure to require broadband and other advanced service technologies to contribute to USF effectively exempts large classes of potential USF contributors from assessment.⁵ The trouble with the Commission's inaction is that

³ 47 U.S.C. § 254(b)(4).

⁴ See AT&T Comments at 17; WorldCom Comments at 3; Sprint Corp. Comments at 4.

⁵ Nextel Comments at 14-16 (discussing the fundamental flaws with the connection-based proposals, all of which fail to bring broadband service providers into the assessment fold). The Commission is considering the appropriate universal service obligations of broadband Internet Service Providers in another proceeding and urges the Commission to resolve that proceeding to require such providers to contribute to the USF. See *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*; *Universal Service Obligations of Broadband Providers*; *Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services*; 1998 Biennial Regulatory Review - Review of Computer III and ONA

it creates a situation in which, according to the Commission's *Staff Study* and conservative assumptions, the projected USF contribution factor increases to over 11.4 percent of end user interstate telecommunications revenue in just 5 years.⁶ This result can be avoided and a revenue-based contribution mechanism can be readily sustained by including voice over IP, *i.e.*, voice service delivered using the Internet Protocol ("VoIP"), and all broadband services as part of the USF funding solution.⁷ In addition to being an achievable solution to the current USF growth problems, this option makes eminent practical sense. The universal service fund, under the terms of the Rural Task Force Order, currently subsidizes rural ILECs in their deployment of broadband networks.⁸ While the Commission may have determined as a policy matter that such funding is appropriate, the obvious effect of the Commission's decision is to allow rural incumbent carriers to use USF funds to build an advanced network at the expense of competitors.

Safeguards and Requirements, *Notice of Proposed Rulemaking*, 17 FCC Rcd 3019, ¶ 65-83 (2002).

⁶ *Staff Study* at 5.

⁷ See TracFone Comments at 14-15 ("If VoIP telecommunications service providers are required to contribute to the Universal Service Fund (as are their circuit switched competitors), a significant amount of funding would be available.").

⁸ Federal-State Joint Board on Universal Service; Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, *Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256*, 16 FCC Rcd 11244, ¶ 200 (2001). There the Commission stated that "although the high-cost loop support mechanism does not support the provision of advanced services, our policies do not impede the deployment of modern plant capable of providing access to advanced services. Rural carriers may consider both their present and future needs in determining what plant to deploy, knowing that prudent investment will be eligible for support. The measures that we adopt in this Order will increase incentives for carriers to modernize their plant by increasing the total amount of high-cost loop support available under the cap."

For this reason, it is critical that broadband networks are included as part of the USF funding solution, as they are emerging as a major source of the USF subsidy challenge.

The whole gambit in this proceeding is fairly simple -- avoid as much as possible and as loudly as possible paying for USF. The interexchange carriers have shed significant USF funding burdens through access charge “reform” and now plainly seek to place the remaining USF funding burden on other carriers. This is the *only* reason that the interexchange carriers want to change the funding mechanism as it now stands.⁹

However, there is no principled policy or legal basis on which to argue that any of the proposed connection-based plans the Commission is considering is more “fair” or equitable than a system based on interstate end user telecommunications revenues, appropriately enhanced by the addition of broadband revenues and VoIP revenues and explicit reflection of the elasticity of demand for each service segment. Indeed, if enhanced in this manner, the revenue-based plan would be more stable and equitable.¹⁰

Each of the connection-based proposals that has been presented as a “solution” to the current revenue-based system is engineered to shift unfairly the USF funding burden away from interexchange carriers and towards CMRS carriers.¹¹ Nextel is not alone in this view and none

⁹ This motivation is patently obvious as the IXC's flatly abandoned their original connection-based CoSUS plan for an even sweeter deal, *i.e.*, the numbers based proposal, which eliminates IXC funding responsibility for USF for the most part.

¹⁰ For example, according to the Commission's *Staff Study*, if Cable Modem, Dedicated Internet access lines (aDSL) and IP toll telephone service were assessed, the total USF contribution base would increase by 16% from \$76.7 billion to \$88.7 billion by 2007. As a result, the projected USF contribution factor would be 9.7 percent versus 11.4 percent. As the broadband market expands and revenue increases, these figures will of course increase as well.

¹¹ Nextel Comments at 8-17.

of the IXC's offered any data or proof to refute this. All of the IXC's early assertions about the simplicity of connection-based plans inevitably have melted away, leaving behind only result-oriented plans that disfavor carriers with network connections, the very thing that USF as a policy is supposed to promote. As Verizon Wireless observed, "the connections-based proposals before the Commission would unlawfully shift a significant share of the burden for funding USF away from IXC's and place a disproportionate burden on CMRS carriers, among others."¹²

In addition, the majority of commenters, including the rural ILECs, CMRS carriers and consumer groups, correctly point out that the legal predicate for "connection-based" assessments – a necessary and critical component for any fundamental change to the wholesale methodology used by carriers to calculate their contribution to the USF – has yet to be established.¹³

Critically, these consumer groups, wireless providers and rural ILECs, as well as emerging technology providers, understand the need to refrain from the sort of changes in USF funding

¹² See Verizon Wireless Comments at 3.

¹³ See, e.g., Comments of the Montana Independent Telecommunications Systems at 3 (recommending that the "Commission refrain from adopting any of the connection-based contribution proposals contained in the 2nd FNPRM because the current revenue-based system continues to effectively achieve the statutory goals of funding USF in an equitable, competitively neutral and non-discriminatory manner. There is not enough evidence at this time to support a conclusion that the revenue-based assessment mechanism is not sustainable."); Verizon Wireless Comments at 23 ("the Commission has not met its burden under Section 254(d) to fashion a connections-based contribution methodology that is not discriminatory and inequitable. The revenue-based system has met those criteria and can be adjusted, as necessary, to ensure continued sustainability of universal service support."); Comments of the Consumers Union, *et al.* at 4 ("Not only is it unnecessary for the Commission to replace the revenue-based system at this time, but each of the three alternative proposals raises significant questions under Section 254 of the Communications Act, which governs the FCC's universal service policies.").

methodology that will weaken innovation and emerging competition.¹⁴ Indeed, as one commenter aptly noted, the “Commission’s [connection-based] proposals would only exacerbate the lack of competition among service providers to serve lower volume customers – hardly a public interest benefit.”¹⁵ The record supports further study of proposed improvements and modifications to the USF funding program. Most comments overwhelmingly reflect a belief that the current revenue-based system is the preferred approach, at least for the next several years.¹⁶

B. The Base of Contributors Must Be Expanded To Enable Funding Stability.

It is evident that if the Commission wants to fund rural ILEC broadband deployment, that the current revenue-based system needs to broaden the base of USF contributors. Indeed, certain commenters, like SBC/BellSouth, attribute the current USF funding volatility to the growth of broadband and new technologies that fuel migration away from the public switched telephone network, or PSTN.¹⁷ Others, such as the IXC’s, attribute the purported lack of USF stability to

¹⁴ As j2 Global Communications, Inc. explained in their comments, free, or nearly free, services such as unified messaging services, would stand to lose the most under a connections-based methodology because any connection fee kills any use of any free or low priced service. j2 Global Communications Comments at 8.

¹⁵ TracFone Comments at 27. *See also* Comments of the Rainbow/PUSH Coalition at 2 (“the Rainbow/PUSH notes that under the [contribution-based methodology] CBM, certain telecommunications companies who provide service to low-volume and low-income consumers (not synonymous) population will be at a competitive disadvantage.”).

¹⁶ *See* Arch Wireless Comments at 4 (“The record in this proceeding unequivocally demonstrates that a revenue-based mechanism, coupled with a safe harbor, continues to be the most equitable, non-discriminatory, sustainable and least administratively burdensome federal USF assessment mechanism.”); CTIA Comments at 2 (“As an initial matter, CTIA believes that the modifications to the revenue-based USF assessment system made in the *Order and Second Further Notice* appropriately addressed concerns regarding the stability of the Fund. Accordingly, CTIA strongly recommends no further modifications to the assessment system at this time.”).

¹⁷ SBC/BellSouth Comments at 2.

their declining revenues. To Nextel, it appears that the real problem with the current USF program *is that the base of contributors is too small for the expanding demands that rural ILECs primarily are making on the fund.* Thus, “rather than adopt rules that are both legally suspect and potentially inequitable, the Commission should alleviate some of the pressure to find more and more sources of contributions by establishing policies aimed at controlling the size of the universal service fund.”¹⁸

The only way to do so, and to ensure the longevity and sustainability of the USF – the overarching goal of this proceeding¹⁹ – is to make broadband providers and providers of VoIP, part of the funding solution and to discipline fund growth without sacrificing competitive service alternatives in rural and former monopoly markets. Increasing the contribution base to include broadband service providers is also consistent with the Act’s requirement that all providers contribute on an equitable and nondiscriminatory basis.²⁰ As one commenter correctly notes, “excluding industry segments that rightfully should contribute under Section 254 would be inequitable and discriminatory vis-à-vis those that do contribute.”²¹ Critically, the statute does

¹⁸ AT&T Wireless Comments at 3. *See also* NTCA Comments at 3 (“NTCA urges the Commission to exercise its statutory authority to include cable, wireless and satellite broadband Internet access providers into the pool of contributors to universal service. Expanding the list of contributors is essential to the continued success of universal service and to the establishment of regulatory parity among all providers of high-speed access to the Internet.”).

¹⁹ *See* Report and Order at ¶ 19 (noting that “we adopt several modifications to the current revenue-based system to ensure the sufficiency and predictability of universal service while we consider reforms to sustain the universal service fund for the long term.”).

²⁰ 47 U.S.C. § 254(b)(4).

²¹ Arch Wireless Comments at 10-11.

not limit assessment to end user telecommunications revenues²² and the addition of broadband providers to the pool of contributors would go far to address the Commission's concerns over the fund's long-term viability.

Obviously, the USF fund cannot be the dumping ground of all other persistent problems and systemic reform challenges faced by the public switched telephone network, particularly when whole classes of service providers are exempt from contributing.²³ As one Commissioner has recently observed, the Commission "shouldn't craft universal service obligations in such a way that they unfairly benefit or burden contributors who compete in the marketplace. Ideally, funding should come from the broadest base of providers and services."²⁴

It just makes sense that broadband providers – some of whose networks and services are subsidized by the fund – contribute as part of the interconnected network of networks upon which communications depends. At the same time, if the USF finances a plethora of programs,

²² 47 U.S.C. § 254(d) ("Any provider of interstate telecommunications may be required to contribute to the preservation and advancement of universal service if the public interest so requires."). While the Commission has concluded that only common carriers should be considered *mandatory* contributors to the support mechanisms, it has concluded that any entity that provides interstate telecommunications to end users could be required to contribute under the Commission's "*permissive*" authority. Federal-State Joint Board on Universal Service, *Report and Order*, 12 FCC Rcd 8776, 9178-9179 (1997).

²³ See, e.g., Nextel Comments at 16 ("[I]f the Commission's approach to the USF contribution methodology will now provide special consideration to those that have contributed to the advancement of competition and competitive facilities investment, then CMRS carriers ought to get the same, if not the majority of that special consideration, [not the broadband providers]."); Comments of Verizon Wireless on the Further Notice of Proposed Rulemaking at 12 (filed April 22, 2002) ("[n]ow is not the time for the FCC to undermine the[] competitive offerings [of CMRS providers] by gerrymandering the assessment methodology to provide a free ride to IXC and competing providers of access to the Internet.").

²⁴ Remarks of Commissioner Jonathan S. Adelstein, OPASTCO, Washington, DC, "Meeting the Challenges of Rural Telecommunications," *Speech*, March 5, 2003.

such as the rebuilding of rural ILEC networks as broadband platforms, access charge reform, replacement of inter-carrier compensation and everything else under the sun, then its size will become enormous. If this happens, winners and losers will emerge not based on the marketplace, but on whether they are the recipients of a USF subsidy. Indeed, unmanaged growth in USF funding requirements stimulates investment by the entities receiving the subsidy at the expense of the growth and development of companies building networks, facing closed capital markets and intense competition.²⁵

The Commission must not lose sight of the fact that USF funding is not supposed to force its recipients into a state where they have little or no incentive to become more efficient or to compete.²⁶ Rather, the Commission must require that *all* providers contribute on an equitable and nondiscriminatory basis and discourage over-investment in subsidized networks at the expense of potential competitors, thereby discouraging competitive entry by CMRS and other alternative providers.

III. THE STAFF STUDY DEMONSTRATES THE NEED FOR REFORM OF THE SCOPE OF THE CONTRIBUTION BASE AND THE APPLICATION OF AN ELASTICITY OF DEMAND ANALYSIS FOR DIFFERENT SERVICES.

To “facilitate discussion and analysis” of the proposed contribution methodologies in the Second FNPRM, the Commission staff released for comment a *Staff Study* that “estimates potential assessment levels under the newly modified revenue-based system and three

²⁵ See Nextel Comments, CC Docket No. 96-45, *et al.*, at 3-9 (filed April 22, 2002).

²⁶ Indeed, it is ironic that cable companies built their broadband networks and CMRS carriers are expected to build their broadband networks without the benefit of public subsidies such as USF funding and rural agricultural loan programs. While Nextel believes there may be limited needs for such public assistance, the fact remains that the availability of a government subsidy does not induce economically efficient behavior from the program recipient.

connection-based proposals.”²⁷ The Commission sought comment both on the “study, as well as its *underlying assumptions*.”²⁸

Not surprisingly, the *Staff Study* shows that, *depending upon the assumptions made*, USF assessment rates will rise more slowly if any one of the three proposed connection-based approach is adopted. A fundamental flaw exists, however, in the assumptions underlying the connections-based plans. They fail to account for the economic welfare costs on telecommunications providers and consumers, which are proportional to differing elasticities of demand for the various services assessed. Indeed, a persistent problem exists with any assessment methodology that requires all service providers to contribute on the same basis and at the same level. This “widget is a widget is a widget” approach yields irrational results in the market and will deprive some consumers of services they value.²⁹

As Nextel demonstrated, increases in the levels of USF assessments on all carriers on the *same basis* create severe market distortions and are not equitable or competitively neutral, as the Act and Commission policy require. All telecommunications carriers are not created equal and the burdens of funding USF and other mandatory programs do not fall evenly on every service

²⁷ *Staff Study* at 1 (emphasis added).

²⁸ *Id.* at 1-2.

²⁹ As other commenters have explained, innovative new services may be particularly disadvantaged by a connection-based assessment. See j2 Global Communications, Inc. Comments at 8 (“one of the services that stands to lose the most under a connections-based contribution system, and especially under the proposed telephone number-based assessment methodology, is the advertising supported UM [Unified Messaging] service offered by j2 Global.”).

provider.³⁰ USF assessments should reflect the conditions of demand for different telecommunications services, which would translate into the USF assessment on a particular service being lower for those services that experience higher elasticity of demand in the final market.

It is well-documented that CMRS customers (and IXC customers) are far more sensitive to increases in price than are the customers of traditional landline local service. Nextel has shown, for example, that mobile wireless service has a high price elasticity of demand relative to other telecommunications services, meaning that an increase in price of wireless service due to an increase in any tax, fee and assessment, or TFA, results in a quantifiable decrease in consumer demand.³¹ Alternatively, the demand for flat-rate local phone service does not appear to be very sensitive to price and thus experiences a much lower demand elasticity than CMRS service.³² Indeed, established economic literature demonstrates that demand for CMRS is over seven times more elastic than is demand for local landline service.³³ Demand elasticity of interexchange service is similar to that of CMRS service. In light of that fact, it is arbitrary and capricious to increase USF funding burden on CMRS carriers, while simultaneously reducing the USF funding burden on IXCs and increasing minimally the funding burden on ILECs.

³⁰ See, e.g., Nextel Comments at 19.

³¹ See Nextel December 2002 *Ex Parte* at Attachment (Impact of Universal Service Reform on the Wireless Industry) page 8 attached to Nextel's Comments (citing to Jerry Hausman, "Efficiency Effects on the U.S. Economy from Wireless Taxation," National Tax Journal, Vol. 53, No. 3 Part 2 (September 2000); Yankee Group Report, "Competition Begins to Have an Impact on Wireless Pricing," April 18, 1997)).

³² *Id.* at Attachment (Impact of Universal Service Reform on the Wireless Industry) page 8.

³³ *Id.*

Policy choices for USF assessments would be improved significantly through adopting some simple economic principles. Indeed, taking account of this fundamental difference among service providers is critical to developing a USF funding program that is competitively neutral and nondiscriminatory when applied across carrier segments. And, any USF funding mechanism that treats each dollar of interstate revenue, each connection, or each assigned telephone number the same for every carrier, without accounting for their elasticities of demand of the different services distorts markets because it distorts consumers' purchasing decisions. Thus, the key to efficient USF assessments lies in considering the responses of customers to relative prices of telecommunication services.

The importance of including "elasticity of demand" as a factor in any contribution proposal can be readily seen by adding to the Staff's analysis an "elasticity of demand" component as one of the underlying assumptions to the revenue-based methodology and to each of the proposed connection and numbers-based reform proposals.³⁴ Indeed, a much different per connection "contribution" result is reached when elasticity of demand is factored into each of the connection-based proposals. Carriers experiencing the lowest elasticity of demand for their services contribute more to the USF as compared to those carriers experiencing high elasticity of demand for their service offerings. Critically, the use of elasticity-based assessments does not affect the contribution base or overall contributions, and the net effect of the methodology is to reapportion the share of contributions or burden based on inverse elasticity among the three

³⁴ The appendix to this filing shows how elasticity weighted contribution factors (for a revenue-based system) and elasticity weighted connection factors can be derived and applied to each of the proposed reforms.

industry segments – IXC, LEC and CMRS – resulting in a lower overall level of economic harm to consumers and operators.

The subsequent charts, for instance, were developed using the same data and underlying assumptions as were used by the Commission staff. They have been modified to include the appropriate elasticity of demand factor for each market segment, and illustrate how the USF funding burdens *should* fall on each industry segment in order to reduce economic costs to both telecommunications providers and consumers.

The relative funding burden, using elasticity-weighted contribution factors, can be calculated as follows:³⁵

Relative Burden Current Revenue-based Approach

	2004	2005	2006	2007
IXC	48%	45%	43%	41%
LEC	28%	29%	30%	32%
CMRS	24%	25%	26%	27%

An Elasticity Weighted Revenue-Based Approach (Interim Revenue)

	2004	2005	2006	2007
IXC	18%	16%	15%	14%
LEC	73%	74%	76%	77%
CMRS	9%	9%	9%	9%

³⁵ The following values are used for the elasticity of demand for telecommunications services in the three industry segments: IXC, LEC and CMRS: (1) Elasticity of demand for wireless services is about -0.7; (2) Elasticity of demand for IXC services is about -0.7; and (3) Elasticity of demand for LEC services is about -0.1. See Nextel December 2002 *Ex Parte* at Attachment (Impact of Universal Reform on the Wireless Industry) page 8 and at Attachment (Economic Welfare Cost of Taxes, Fees and Assessments) pages 14-15.

An Elasticity Weighted Connection-Based Approach 1 – Modified CoSUS

	2004	2005	2006	2007
IXC	5%	5%	6%	6%
LEC	88%	87%	87%	86%
CMRS	7%	8%	8%	8%

An Elasticity Weighted Connection-Based Approach 2 – SBC/BellSouth

	2004	2005	2006	2007
IXC	14%	14%	14%	14%
LEC	68%	68%	67%	66%
CMRS	17%	18%	20%	20%

An Elasticity Weighted Connection-Based Approach 3 - Numbers Based Proposal

	2004	2005	2006	2007
IXC	3%	3%	3%	3%
LEC	91%	90%	90%	90%
CMRS	6%	7%	7%	7%

This analysis plainly demonstrates that an economically more rational approach that is attuned to avoiding unnecessary consumer and producer welfare losses would change what each industry segment would pay to fund USF. It also demonstrates that implementing a program change that appropriately makes elasticity of demand distinctions will not require a major overhaul of either the existing revenue-based USF assessment approach or any of the connection-based plans that the Commission appears to prefer. It would allow the Commission to adjust periodically demand elasticity based on evolving market data. Equally important, such an approach would be consistent with Section 254(d)'s "equitable and non-discriminatory" requirement, because it would reduce the possibility of economic market distortion. Competitive neutrality requires the Commission to engage in this exercise.

IV. SEVERAL ASPECTS OF PARTICULAR CONNECTION-BASED PLANS MILITATE AGAINST THEIR WHOLESALE ADOPTION.

Nextel has indicated that some form of connection-based assessment could eventually be a logical outcome to the USF funding conundrum.³⁶ However, none of the three connection-based proposals presented in the Second FNPRM represents a satisfactory or reasonable modification of the current revenue-based assessment program.

First, as demonstrated above, none of the proposals account for the economic welfare costs on telecommunications providers and consumers which are proportional to the different elasticities of demand faced by distinct industry segments. Doing so, as the data presented demonstrates, results in wholly different monthly contributions per connection, and is the only way in which any of any connection-based plan can pass legal muster under the Act. Second, each connection-based plan starts at some *arbitrary* point and resorts to some minimum contribution, or other approach, to recapture interstate activities of interstate carriers that are otherwise exempted under the particular form of proxy chosen. Under the statute, however, “[e]very telecommunications carrier that provides *interstate* telecommunications services shall contribute, on an equitable and nondiscriminatory basis” to the federal fund.³⁷ And, no foundation is ever laid to support the starting points or the approach selected (*e.g.* \$1.00 per residential or wireless connection) to demonstrate that it is equitable and consistent with the Act.

³⁶ Nextel Comments at 7.

³⁷ 47 U.S.C. § 254(d) (emphasis added).

Importantly, while generally the connection-based proposals share similar defects, individually, each of the plans contains its own specific flaws.³⁸ For example, the Modified CoSUS Proposal which sets an initial per connection fee at \$1.00 per line per month and includes a “minimum contribution” requirement, would provide interexchange carriers with an unwarranted windfall at the expense of other contributors. The extremely limited 10% minimum contribution that is meant to recapture a portion of this loss is not supported by interexchange carrier commenters or many other commenters, as a fair and reasonable result.

The SBC/BellSouth proposal – which splits connection-based contribution assessments between switched access and interstate transport providers – is more egregious in its adverse treatment of competitors. This plan would assess wireless services twice, *i.e.*, once for the connection aspect and once for the transport aspect of a wholly integrated service, while LECs and IXC would be assessed only once.³⁹ Even the Commission recognizes the inequity of such a plan: “CMRS providers and wireline carriers that provide both local and interexchange services to the end user would be assessed two units per connection (one for access and one for transport),

³⁸ Nextel sets forth a complete discussion of the shortcomings associated with each of the connection-based plans proposed in the Second FNPRM in its initial comments. *See generally* Nextel Comments at 10-18. To avoid unnecessary redundancy, Nextel does not repeat all of the arguments presented in its initial comments but incorporates them by reference herein.

³⁹ Certain rural ILECs support the SBC/BellSouth based approach over the others because splitting total contributions between IXCs and access providers relies on the logic that all interstate communications require both a connection to a local distribution network and a connection to a network that actually transports the communication across state lines. Thus, these providers believe that this proposal “provides the most equitable distribution of support and best meets the Act’s requirement that all service providers contribute in an equitable and nondiscriminatory manner.” Comments of Fred Williamson and Associates, Inc. at 18.

while a LEC that does not provide interexchange service would be assessed one unit, and the interexchange carrier serving the customer would be assessed one unit.”⁴⁰

Finally the Numbers-Based plan – which would assess USF fees on the basis of assigned and working telephone numbers a carrier may have – would significantly relieve interexchange carriers from their USF funding requirement. In addition, the Numbers-Based plan would explicitly exempt broadband providers from the potential of ever contributing. They do not use telephone numbers *at all* in their provision of telecommunications. For this reason alone, the Commission must reject telephone numbers as the proxy or assessment method for USF, as adoption of a Numbers-Based approach could be used later as an excuse for failing to assess broadband service connections.

Furthermore, a Numbers-Based plan simply cannot work if does not back out from its assessment base those numbers that are assigned, but not currently associated with a working connection. Indeed, by using “assigned” numbers, rather than working numbers, the Commission would require carriers to pay more into USF than they can collect back from their customers. This is a serious deficiency, as carriers are now left to recover USF assessments from sources other than end user USF fees. It is also uncertain how, under the Numbers-Based plan, ported telephone numbers and those used by resellers would be counted for USF purposes. Indeed, it is the underlying carrier that is typically assigned a number that has been ported to another carrier or that is in use by a reseller, yet it is the carrier that receives the ported number and the reseller that obtains the revenue from the customer associated with those telephone numbers.

⁴⁰ Second FNPRM at ¶ 86.

In addition, the Commission seems to suggest that a Numbers-Based plan “might encourage public policy goals such as the conservation and optimization of existing telephone number resources.”⁴¹ Nextel submits that such a proposal would not significantly enhance number conservation, which has been effectively addressed by thousands-block number pooling. As Nextel mentioned in its initial comments, the Commission already has placed a set of demanding numbering utilization thresholds and obligations on all carriers and there is no added public benefit to be gained from adopting a numbers-based assessment for universal service purposes.⁴² In addition, Nextel submits that ILEC rate consolidation is a far greater unresolved numbering conservation measure more worthy of the Commission’s attention than would be a numbers-based USF assessment.

V. ANY REVENUE-BASED SYSTEM MUST MAINTAIN FLEXIBILITY TO RECOGNIZE RELEVANT DIFFERENCES AMONG INDUSTRIES AND BETWEEN CARRIERS.

The record demonstrates that most commenters believe that a full scale departure from the current revenue-based assessment program is unwarranted at this time. For example, Verizon Wireless observes that the “problems presented by connections-based proposals are far more daunting than those ascribed to the revenue-based system.”⁴³

⁴¹ *Id.* at ¶ 96.

⁴² Nextel Comments at 17. The rules promulgated pursuant to Section 254 must be designed to ensure the viability of the USF. They should not be designed to address the Commission’s number conservation issues, particularly number utilization, which already has been addressed effectively by other rules.

⁴³ Verizon Wireless Comments at ii.

If a revenue-based system is maintained, the Commission has indicated that CMRS providers should develop systems for estimating interstate revenue that do not rely upon a Commission-prescribed wireless safe harbor. While this makes sense, the reality among wireless carriers is that their networks differ. Indeed, challenges certainly exist for wireless carriers that seek to measure interstate telecommunications revenues. Nextel also agrees with Verizon Wireless that certain wireless carriers can fairly estimate their interstate telecommunications revenues by using interstate minutes of use as a proxy for revenues. Such traffic studies provide a reasonable basis for determining individual carriers revenue allocations. Thus, as Verizon Wireless notes, these individual carrier filings can, in turn, form the basis for a wireless safe harbor for use by CMRS carriers that are unable, for technical or economic reasons, to perform their own traffic studies much as smaller LECs currently are allowed to rely on average schedules to determine their costs for access charge purposes.⁴⁴ Thus, Nextel supports the use of a safe harbor for those wireless carriers that cannot determine their interstate revenues by using traffic, periodically sampled, as a proxy. As Nextel stated in its initial comments, the Commission should be as flexible as possible in its adopted assumptions/proxies for wireless providers that engage in any form of estimation of the jurisdictional nature of their traffic.⁴⁵

Importantly, the Commission must be flexible in determining how carriers should determine the jurisdictional nature of calls originating and terminating on their networks. Nextel does not believe that the Commission should mandate use of the originating cell site and the terminating area code or NPA-NXX of a call to approximate the jurisdictional nature of airtime

⁴⁴ *Id.* at 5.

⁴⁵ Nextel Comments at 24.

minutes. As explained in its initial comments, Nextel's systems capture and can analyze the originating and terminating NPA-NXX of the calling and called parties – in many but not all cases – to estimate the jurisdiction of airtime minutes. Any mechanism employed by the Commission that would mandate that Nextel or other wireless carriers use *only* the originating cell site rather than the NPA-NXX would require a massive billing system overhaul that would take time and be costly to implement.⁴⁶ As Nextel would have no reason to make this change, it is difficult to see why the Commission would force it upon one or more wireless carriers.⁴⁷ There is no reason for the Commission to select one approach over the other and any rules of the road established for traffic measurement should reflect the network differences that exist among CMRS providers.

⁴⁶ See Nextel Comments at 26-27.

⁴⁷ The Commission must also reject AT&T's misinformed notion that it could somehow ever be practical to require CMRS carriers to develop the capability to bill end users based on their "actual" interstate usage. The CMRS market exploded precisely because consumers wanted undifferentiated bucket of minutes and the regulatory process should not require CMRS carriers to recreate a system that bears no resemblance to the way they do business.

VI. CONCLUSION

The majority of comments urge the Commission to refrain from drastic changes to the USF revenue-based assessment mechanism. Regardless of the approach taken at this point, however, one thing is certain – for any contribution proposal to work and conform with the requirements of Section 254, it must account for the conditions of demand for different telecommunication services.

Up until now, important decisions regarding USF contributions have been made based on ad hoc reasoning in the absence of clear guidance from economic theory. This can and must change. The key to efficient USF assessments lies in considering the responses of customers to relative prices of telecommunication services – a consideration that can easily be applied to any assessment methodology adopted.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Cynthia S. Shaw, a legal secretary at Drinker Biddle & Reath LLP do hereby certify that on this 18th day of April, 2003, a copy of the foregoing “**REPLY COMMENTS OF NEXTEL COMMUNICATIONS, INC.**” was sent via hand delivery to the following:

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